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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

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Dup. Ct.

No. 587

IN THE MATTER OF
DIVERSEY HOTEL CORPORATION,
AN ILLINOIS CORPORATION,
DEBTOR.

ABRAHAM KOSDON, SAM HAUSLINGER AND BENJAMIN LAPINE,
Petitioners,

vs.

DIVERSEY HOTEL CORPORATION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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February 9, 1948.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the United States:

Abraham Kosdon, Sam Hauslinger and Benjamin Lapine respectfully pray the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit to reverse its judgment of Janu-

ary 21, 1948, affirming the Order of the District Court for the Northern District of Illinois Eastern Division approving the voluntary Petition of the Diversey Hotel Corporation for corporate reorganization under Chapter X of the Bankruptcy Act as filed in good faith, to the end that its judgment may be reversed with directions to dismiss the proceeding for lack of good faith.

Summary Statement of the Matter Involved.

The Diversey Hotel Corporation was organized as a Delaware corporation in December 1932 under a reorganization plan (R. 5) which was then adopted by a protective committee consisting of five persons headed by George W. Pearson (R. 67). Under the plan the Delaware corporation acquired the property of the Illinois corporation and issued $1,387,500 in income bonds in exchange for the defaulted first mortgage bond of the same amount due June 1, 1947 together with 100 shares of stock which were to be held by the five members of the committee in trust, for distribution to the bondholders on a pro-rata basis at or prior to the maturity of the income bonds (R. 5, 74). The plan provided for a voluntary modification of the terms of the bond issue and for the sale of the property free and clear of the mortgage lien upon consent of the requisite number of the outstanding bonds. In the event of foreclosure all redemption rights were waived and the indenture trustee was authorized to purchase the property for the benefit of the bondholders if it did not obtain a fair price at the foreclosure sale, and it could organize a new corporation and issue stock in lieu of the bonds. On June 1, 1947 it became the mandatory duty of the trustees to distribute the stock to the bondholders (R. 14, 15, 17).

Without the knowledge or consent of the bondholders who were also the beneficiaries of the stock which was

held by the members of the committee in trust, the officers of the corporation created the debtor, The Diversey Hotel Company, as an Illinois corporation and had the Delaware corporation convey all of the property to the Illinois corporation on September 29, 1938 (R. 6). Instead of distributing the stock of the Delaware corporation or the proceeds thereof, the officers of the corporation issued the stock of the Illinois corporation to three strangers with an endorsement on the certificate that these strangers were to hold the stock in trust for the benefit of the bondholders under the same terms and conditions as the committee held the stock of the Delaware corporation (R. 85). Immediately thereafter these three strangers surrendered their stock to the corporation and all of the stock was re-issued to George W. Pearson, individually, under a similar endorsement that he was to hold the stock for the benefit of the bondholders under the same terms and conditions as they were to be held by the five members of the protective committee (R. 85). Pearson, as the sole stockholder thereafter, was the only person to give notice and to receive notice in connection with election of directors, and he, the one man corporation, elected the directors (R. 85). From the date of the reorganization in 1932 to the date of the filing of the Petition on May 29, 1947, two days before the maturity of the income bonds, not one cent was paid on the principal. No attempt was made to obtain a voluntary reorganization under the plan which was adopted by Pearson and the other members of the committee in 1932 at the cost of $31,429.31 (R. 63) but instead of this, he, Pearson, through his Board of Directors, filed the voluntary Petition for alleged corporate reorganization on the eve of the maturity of the bond issue when he was obligated to distribute the stock to the bondholders.

The good faith was contested at the outset by the

Petitioners (R. 12-20) who owned $21,000 of the income bonds and who are beneficiaries of the stock for the corresponding amount and who made a demand prior to the filing of the Petition for the distribution of the stock (R. 21). Evidence was heard by the Court which established that the property of the debtor is valued less than the debt due on the mortgage indebtedness, and that the main object of the proceedings was liquidation and not reorganization. The Court, however, approved the Petition as filed in good faith (R. 34) and the Court of Appeals affirmed its order (R. 110).

Questions Presented.

1. Whether in a contest on the good faith of a voluntary petition for reorganization under Chapter X of the Bankruptcy Act made at the outset of the proceedings under Sections 137 and 144 and the showing that the property of the debtor was worth less than the mortgage debt and its object was liquidation and not reorganization, it was proper to affirm the order below that the petition was filed in good faith for the reason that "the instant proceeding might be a crutch to carry the bondholder through" to "end" their "long period of convalescence," and whether such views are in harmony with the view of this court as expressed in *Marine Properties* v. *Trust Co.*, 317 U. S. 78; *Fidelity Assurance Society* v. *Sims*, 318 U. S. 608.

2. Whether a "breach of trust" and "breach of fiduciary integrity" on the part of the persons who plunged the corporation into bankruptcy to avoid the performance of their trust duties does not constitute lack of good faith.

3. Whether a corporation whose stock was wholly owned by the bondholders and there were no intervening

rights, may avail itself of voluntary proceedings under Chapter X of the Bankruptcy Act for liquidation purposes under the guise of reorganization, and whether the merger of the bonds into the stock upon the maturity of the income bonds which would have vested the title in the corporation free from the lien of bond issue, without requiring any reorganization, should have been prevented by the Court of Bankruptcy in approving the petition as filed in good faith.

4. Whether the reviewing Court may confirm a judgment below in disregard of the points raised on the appeal and without passing on the questions presented on review consisting of the following:

(1) Whether petitioner met the burden of proof to sustain its jurisdictional allegations when its good faith was contested at the outset under Sections 137 and 144 of the Act.

(2) Whether the persons who violated the provisions of the 1932 reorganization plan and committed a breach of trust when they caused the Delaware corporation to convey the property to the Illinois corporation, acted in good faith in filing the petition for a second reorganization.

(3) Whether it was the duty of the officers and directors of the debtor corporation to exhaust the provisions for a voluntary reorganization under the 1932 reorganization plan before throwing the debtor into reorganization under Chapter X encumbering the estate with the expenditures necessarily incurred under the Act.

(4) Whether the conveyance by the Delaware corporation, which only requires the consent of 51% of the stockholders to a sale or mortgage to the Illinois corporation, which requires the consent of two-thirds of the stockholders to a sale or mortgage, was a breach of trust in view of the fact that the stock was to be held by the Committee for the benefit of the bondholders with the limitation to distribute the stock

or the proceeds thereof, and the consent of the beneficiaries was not obtained to such transfer, and whether the filing of the petition by the Illinois corporation, which was conceived in fraud, was in good faith under the spirit of the Act.

(5) Whether the real purpose of the proceeding was liquidation and not reorganization and it was the duty of the court to dismiss the proceeding for lack of good faith,

all of which questions were embraced in the specification of the points relied on for reversal.

Reasons for the Allowance of the Writ.

1. The approval of the voluntary petition as filed in good faith upon the contest at the outset of the proceedings on a showing that the value of the property of the debtor was less than the mortgage debt and that the proceedings were not for reorganization, but for liquidation, and the affirmance of the order for the reasons advanced in the opinion that "the instant proceedings might be a crutch to carry the bondholders through to end their long period of convalescence", cannot be justified in view of the fact that the proceedings were not initiated by bondholders but by a "one-man corporation" on the eve of the maturity of the bond issue when he was to distribute the stock to the bondholders. The views expressed in the opinion are contrary to the views of this court as expressed in *Marine Properties* v. *Trust Co.*, 317 U. S. 78, and *Fidelity Assurance Society* v. *Sims*, 318 U. S. 608, as interpreted by the Second Circuit (re: *Loewer's Gambrinus Brewery Co.*, (2) 747; *County Life Apts.* v. *Buckley*, 145 F. (2) 9[illegible] well as by the Seventh Circuit in its previous opinions (*Biltmore Grande Apts.*, 146 F. (2) 81; *Lorraine Castle Apartment Bldg. Corp.*, 149 F. (2) 747.

2. The approval of a voluntary petition of a debtor as filed in good faith under Chapter X of the Bankruptcy Act on a contest at the outset of the proceedings in the face of the failure of proof to sustain the jurisdictional requirement as to "need for relief" and the proof that the object was not to reorganize but to liquidate cannot be reconciled with decisions of other circuits and with the decision of this court. The definition of good faith in the instant case, that good faith under the Act "is not the same as the alleged breach of fiduciary integrity" is a novel definition which is not in harmony with the definitions of the term by other courts.

3. The approval of the voluntary petition of the debtor, in the absence of proof to sustain the jurisdictional allegations, on the ground that some bondholders favored the reorganization proceeding because the proceedings "might be a crutch to carry the bondholders through" and "end" their long "period of convalescence" is based on a clear misconception of the scope and purposes of corporate reorganizations under Chapter X of the Bankruptcy Act, as it was not the purpose of corporate reorganizations to supply "crutches" to bondholders. Even if all the bondholders had filed a petition, it would have had to be dismissed for lack of good faith, when the basic jurisdictional requirements were absent. The "wish" of the bondholders holding $88,000 in bonds who supported the voluntary petition may not be a substitute for jurisdictional requirements which are absent. The affirmance of the order approving the petition as filed in good faith is not based on good faith as defined in Section 146 (3) but on good faith as defined in the Opinion which is not in accord with the view of this court. The writ should be issued to review such a decision.

4. The views expressed in the opinion that the issue

of good faith on a voluntary petition when assailed at the outset by creditors must be determined not by the allegation and proof, but by the wishes of creditors who believe "that something worthwhile can be saved from the wreck", by means of the proceedings which they themselves could not have maintained, is contrary to the views of this court.

Prayer.

For the foregoing reasons petitioners pray that a writ of certiorari issue out of this court to the United States Circuit Court of Appeals for the Seventh Circuit directing said court to certify and send to the court on a date to be determined, a full and complete transcript of the record and of all proceedings there had in this case, to the end that the case may be reviewed and determined by this court, that its judgment and decision be reversed with directions to dismiss the proceedings for lack of good faith and that your petitioner be granted such other and further relief as may be proper.

ABRAHAM KOSDON, SAM HAUSLINGER,
and BENJAMIN LAPINE,
Petitioners.

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and
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Respondent.

BRIEF IN SUPPORT OF PETITION.

Jurisdiction Invoked.

The judgment of the United States Circuit Court of Appeals was rendered January 21, 1948, and the jurisdiction of this court is invoked under Judicial Code Section 240 (a) 28 U. S. C. A. Section 547 (a) as amended by the act of February 13, 1925.

Opinion Below.

The opinion of the Court of Appeals is not yet reported and is printed in the record (pp. 104-109).

A STATEMENT OF THE CASE.

The petition involves the approval of a voluntary petition to reorganize the Diversey Hotel Corporation under Chapter X of the Bankruptcy Act on a contest at the outset of the proceedings by petitioners on the issue of good faith. The matter was heard upon the petition, the answer, and evidence both oral and documentary. The court approved the petition as filed in good faith and the Court of Appeals affirmed the decision below.

The Petition:

The petition alleged (R. 2-5) that the debtor was an Illinois corporation and its assets consist of two buildings: (1) an office building and (2) a hotel valued at $1,450,000, and together with other assets the total value of the debtor's property is $1,512,902.79 against liabilities of $1,424,578.74. The Corporation issued 100 shares of $10 par value each in the name of George W. Pearson, its president, which he holds for the benefit of the first mortgage bondholders in the amount of $1,387,500.00.

In stating the "History of the Property" the petition alleged (R. 5) that the property was foreclosed in 1932 for the debt on First Mortgage Bonds of $1,387,500, at which time the Diversey Hotel Corporation (a *Delaware* corporation) was organized which purchased the property at the foreclosure sale under a Reorganization Plan which was adopted by a Protective Committee. The Company issued new Income Bonds in exchange for the old 6% Bonds. Its common shares were issued in the name of the Committee whose members became the directors of the corporation headed by George W. Pearson, its chairman, with authority to distribute it pro rata among the bondholders

or to sell the stock and distribute the proceeds among them. The stock had not been sold nor distributed to date and is held by Pearson for the benefit of the bondholders. On September 29, 1938, the *Delaware* corporation conveyed the property to an Illinois corporation which assumed the bonded debt of $1,387,500 maturing June 1, 1947. The company had no funds to meet the payment of the bonds at maturity.

The Petition was filed on May 29, 1947 (two days before the maturity of the bond issue) and alleged that there were no other proceedings pending either in the State or Federal Court for reorganization or foreclosure, except a suit for damages under the Dram Shop Act. It alleged (R. 6: ¶ 8) the "need for relief" and that its assets were valued in excess of its liabilities but it was unable to meet the payments as they matured, and under the Act it would salvage most, if not all, of the intrinsic value of its equity and the creditors would not be obliged to sacrifice their claims in a foreclosure sale or in a straight bankruptcy proceeding, and it desired that a Plan of Reorganization be effected under the Act.

The Answer:

The answer of the appellants, secured creditors to the extent of $21,000.00 (R. 19-20), challenging the good faith of the petition under Sections 137 and 144 of the Act, alleged (R. 12: ¶ 2) that the directors of the Corporation were without power to vote in favor of the filing of the petition because of the violation of their duty to distribute the stock or proceeds to the bondholders and they had no right to act in behalf of the corporation. It denied (R. 14: ¶ 8) that the value of the debtor's property was $1,450,000, denied its solvency, and denied that its assets are in excess of its liabilities. It denied (R. 14: ¶ 8) that there

was any need for reorganization under Chapter X, and asserted that reorganization was possible under Section 5 of Article XI of the Trust Indenture which was executed pursuant to the 1932 reorganization plan authorizing 80% of the outstanding bonds to alter or amend its provisions; that relief was also obtainable under Section 4 of Article VI of the Trust Instrument under which the corporation waived its right of redemption, and further relief was available under Section 5 of Article X which authorized the trustee to purchase the property at the foreclosure sale for the benefit of the bondholders and to issue stock under a trust or a corporate form. Relief was also available by a partial sale without consent, or by the sale of the whole property by consent of 75% of the outstanding bonds.

The answer further alleged (R. 16-18) that the assets of the debtor were valued at less than the amount due on the bond issue and that only a liquidation may be accomplished in these proceedings for the sole benefit of the secured creditors and not a reorganization in the real sense, and the petition was, therefore, not filed in good faith; that (R. 19) the filing of the petition was not in good faith because the corporation ceased to function; that the directors of the corporation were merely custodians for the shareholders whose shares were to be distributed under the plan and they were without power to act; that the shareholders were prevented from operating its business since the reorganization in 1932 and that the filing of the petition was in furtherance of the attempt of the directors and officers to perpetuate themselves in office.

Petitioner's Evidence:

The only evidence in support of the petition which was offered by the Petitioner consists of four documents (Exhs. 1-4). Three of these exhibits are letters written by the

Bondholders Protective Committee to the bondholders during the period commencing May 16, 1933 to January 30, 1935, and the fourth exhibit is the Trust Agreement (R. 92) which was executed June 1, 1932 under the Reorganization Plan and to which the court authorized a reference without reprinting it.

The first letter dated May 16, 1933 (R. 72; Exh. 3) shows that the Committee consisted of George W. Pearson, Chairman, W. C. Collings, Ralph DeSwarte, E. Rahtjen and Harry L. Schmitz, and the Continental Bank was the depositary of the Committee. The Committee stated in its letter (R. 74) that it organized the Diversey Hotel Corporation under its Plan of Reorganization to acquire the property at the foreclosure sale and that the Corporation would issue new Income Bonds in exchange for the old bonds. In its second letter, dated June 1, 1934 (R. 67; Exh. 2) it stated that the Diversey Hotel Corporation was organized in December, 1932 and that the members of this Committee were elected Directors of the company. Upon the completion of the foreclosure the title to the property became vested in Diversey Hotel Corporation, and "the banker members of the Committee felt they should be replaced on the Board by bondholders or experienced real estate operators" and "accordingly, on December 19, 1933, Messrs. George W. Pearson, Ralph P. DeSwarte and Harry L. Schmitz, resigned from the Board of Directors of Diversey Hotel Corporation and the vacancies so created were filled by the election of Carleton L. Elmes and George Donnersberger, holders of Certificates of Deposit for substantial amounts of bonds and Francis Manierre, a well known real estate operator." It also stated that the Corporation acquired title to the property on January 3, 1933 and that the Committee did not know definitely when the new securities would be issued in exchange for the old securities. In its third letter, dated January 30, 1934 (R. 61;

Exh. 1) the Committee informed the bondholders that each of the new bonds contained the following legend (R. 62):

> "In accordance with the plan of March 22, 1932, pursuant to which plan this bond was issued, at the time of issuance of this bond all of the capital stock of the Diversey Hotel Corporation was retained by a committee acting for the benefit of the holder of this bond and the holders of all other bonds secured by the Trust Indenture referred to in the within bond. At such time as the Committee holding such stock shall distribute the same the then registered owner of this bond shall be entitled to receive his pro rata share thereof."

and that on the basis of the then rentals it was estimated that there would be paid at least ½ of 1% on June 1, 1935 on account of interest on the new bonds.

No evidence was offered by the Petitioner on any of the jurisdictional allegations contained in the petition, and none of the exhibits have any bearing on proof of the petitioner.

Evidence in Opposition:

The evidence of the appellants showed (R. 84) that prior to the filing of the petition the directors adopted a resolution to obtain the consent of the bondholders to an extension of the Income Bond Issue, which resolution was never rescinded. When the Diversey Hotel Corporation (the *Delaware corporation*) conveyed its property to the Diversey Hotel Corporation (the *Illinois corporation*) the shares were issued to three persons, in compliance with the Illinois law, on October 1, 1938. One share was issued to M. Barton, one share to M. J. Fink, and 98 shares to B. P. Hayes. All of these shares were immediately canceled and 100 shares were issued to George W. Pearson. He is the sole stockholder of the debtor corporation, and the stock is still in an envelope in the corporate book (R. 85). Each

of the certificates when originally issued contained the following endorsement:

> "This Certificate issued subject to the terms and conditions contained in Section Eight (8) of Article One (1) of the Trust Deed dated June 1, 1932, executed by the Diversey Hotel Corporation and the Continental Illinois National Bank & Trust Company of Chicago, as Trustee."

and the certificate issued to Pearson contain a similar endorsement (R. 85).

On August 22, 1946, an offer of $1,200,000 for purchase of the property was made. The offer was rejected by the Board of Directors, without consulting the bondholders. The reason given for the rejection was that the Corporation had obtained an appraisal from the Chicago Real Estate Board showing the value of the property to be $1,350,000, and the amount of the indebtedness was $1,387,500 (R. 86). On September 20, 1946, at a special meeting of the "stockholders" (*which consisted of Pearson, the sole stockholder*) it was decided (R. 87) to abandon a proposition for the sale of the stock, and to submit to the bondholders a program of extension and part payment in cash (R. 88-89). On December 10, 1946 the Illinois corporation first assumed the liability of the Delaware corporation to pay interest, and the attorneys were instructed to prepare a draft to amend the charter of the Corporation towards a program of voluntary reorganization (R. 87). The directors also caused the property to be advertised for sale on April 15, 1947 (R. 23; Exh. C). Thereafter, on May 29, 1947 there was a special meeting of the Board (R. 90) and its attorneys reported that the sale of the property fell through, and (R. 91) that they thought "it's too late now to consider making any sale" because nobody would go into it "between now and the first of the month, with the intervening holiday tomorrow, and make any kind

of a deal," and under the circumstances they recommended the filing of the petition under Chapter X "with a view toward developing a program of reorganization that will permit" the substitution of "some single type of security that could be sold with a degree of freedom from the complications that exist under the present reorganization plan"; that (R. 93) they "have prepared a petition for this purpose" which they "are handing" to the Board "now" and asked them to "look it over and make such appropriate resolutions as you may see fit to pass under the circumstances." The resolution prepared by them to file the petition was then adopted (R. 97) and filed on the same day.

ARGUMENT.

I.

The Property of the Debtor Was Worth Less Than the Amount Due on the Mortgage and the Proceedings Were for the Purpose of Liquidation and Not Reorganization. The Decision Which Approved Such a Petition as Filed in Good Faith on a Contest at the Outset of the Proceedings Is Irreconcilable With the View of This Court.

The good faith of the petitioner was challenged at the *outset* under Sections 137 and 144 (R. 12-120). The allegation that the assets of the debtor exceeded the value of the mortgage indebtedness was challenged (R. 18) and it was asserted that "the assets of the debtor" were worth "less than the first mortgage indebtedness" and that (R. 19) the proceedings were for "liquidation" and not filed in good faith. On such a contest, the debtor *had the burden* of proof (*Marine Properties* v. *Trust Co.*, 317 U. S. 84, 85). It did not offer *any* evidence tending to sustain the allegations. On the other hand the proof showed that *the value of the assets was $1,350,000* (R. 86) against an indebtedness of $1,387,500, and there were no other intervening rights as the stock of the debtor was held for the bondholders (R. 5). For the purpose of showing good faith the petition alleged that the real estate was valued at $1,450,000 and that together with other assets the whole property of the debtor was worth $1,512,902.72 (R. 5) against liabilities of $1,424,578.74. The proof shows that on August 22, 1946 the debtor's property *was appraised at $1,350,000* which was *less* than the bond issue of $1,387,500 (R. 86). Even if there be added to the $1,350,000 the $45,409.43 in cash,

the $1,069.22 in "accounts receivable", the $5,139.64 in "premiums on insurance" and $11,284.43 in "deferred tenant alterations", the total assets amounted to $1,411,-833.50 as against a total liability of $1,424,578 (R. 5). That the real object of the proceeding was *not* for reorganization but for "liquidation" appears from the statement of the attorneys who prepared the petition who in urging the Board to vote for its filing stated (R. 91): "Under the circumstances" they "both feel" that they "can only recommend to the corporation that it file a petition to reorganize under Chapter X with a view toward developing a program of reorganization that will permit you to have some single type of security that could be sold with a degree of freedom from the complications that exist under the present trust indenture and the present reorganization plan." It was not the object to give the corporation a new start in life, which is the purpose of Chapter X, or "a new career" (*North American Can Corp.* v. *Peerless Weighing and Match Corp.*, 143 F. (2) 938), but its object was to simplify the liquidation and it is apparent that there was nothing for the stockholders because the bondholders themselves were the stockholders.

In discussing the "good faith" of the debtor in filing the voluntary petition the opinion finds support in the desire of the "creditors" who did not and could not have filed an involuntary petition, and it referred to instances where "creditors whose investment has turned sour" and "to save something of the wreck" are resorting to "cause a petition to be filed" and in such a case the question of good faith on the part of such creditors is involved and that is what is meant by good faith to "avoid the milking of the embarrassed debtors" and "the enrichment of a few professional reorganizers possessed of mischievous hungry proclivities." To this end the opinion says the District Court is charged with the duty of preventing this misuse

by the test of good faith. The court lost sight that while the term "good faith" may include the matters suggested by the court, it does not exclude the test defined in Section 144 and even in cases where creditors have the best intentions, and where debtors honestly believe that the proceedings would serve the best interest of the creditors, a petition is not filed in good faith when no reorganization but liquidation must be the ultimate end and such good faith may be challenged by a single creditor and must be dismissed irrespective of the large number of creditors who may desire it and of the benefits which may result therefrom.

While it may be true, as said in the opinion (R. 107), that the phrase "good faith" is not a term of precise or restricted meaning and it must find its correct connotation in the facts and in the field wherein it is used, yet a court may not go far afield as to hold that where there was no good faith because it appeared that the ultimate result would lead to liquidation, that such a petition should nevertheless be approved as filed in good faith. When it appeared from the evidence that the value of the assets was less than the debt due on the first mortgage and that there were no intermediary rights as the bondholders were, themselves, the stockholders and the inevitable result was liquidation, it became the duty of the District Court to dismiss the proceedings without regard to the wishes of the creditors who aligned themselves with the debtor under the definition of good faith by this court in construing the statutory definition.

The test whether a voluntary petition is filed in good faith is not determined by the desire of creditors who could not have invoked the voluntary or involuntary proceedings and who come to the support of the debtor. It is the good faith of the debtor which filed the voluntary

petition which is in issue and not the good faith of the creditors who come to its aid, and the issue can only be determined upon the contest of the creditor irrespective of the desires of other creditors (*Re Marine Harbor Properties,* 125 F. (2) 296, 299).

The affirmance of the order approving the petition as filed in good faith in the face of the evidence that the ultimate result would lead to liquidation, cannot be reconciled with the views of this court.

In *Fidelity Assurance Society* v. *Sims,* 318 U. S. 608, the Supreme Court construed the "good faith" provision of Chapter X, and said (p. 615):

> "Section 144 requires that if the Judge is not 'Satisfied' that the petition 'has been filed in good faith' he shall dismiss it. The relevant portions of 146 are that a petition shall be deemed not to be filed in good faith if * * * (3) *it is unreasonable to expect that a plan of reorganization can be effected;* or (4) a prior proceeding is pending in any court and it appears that the interest of creditors and stockholders would be best subserved in such prior proceeding." (Italics ours.)

The provisions as to "good faith" under Chapter X are also discussed in *Marine Properties* v. *Trust Co.,* 317 U. S. 78. There, the court said (p. 83) *that the burden is cast upon the petitioner to show that the proceeding was filed in good faith,* and that "Congress in effect directed the bankruptcy courts not to approve petitions under Chapter X in such cases unless it appears that the interests of creditors and stockholders would not be best subserved in the prior proceeding and *it put the burden on the petitioner to make that showing".*

In *Marine Properties* v. *Trust Co.,* 317 U. S. 84. At p. 85 the court said:

"We are of the opinion, however, that *the debtor did not sustain the burden which the federal statute places on a petitioner.* * * * 'Admittedly, the property is worth less than the amount of the first mortgage indebtedness. Under the rule of *Northern Pacific Ry. Co.* v. *Boyd*, 308 U. S. 106, *a plan of reorganization would not be fair and equitable which in such circumstances admitted the stockholders made a fresh contribution in money or in money's worth, in return for "a participation reasonably equivalent to their contribution"* ' (*Case* v. *Los Angeles Lumber Co., supra*, p. 121. *That rule obtains under Chapter X as well as under its predecessor*, § 77B. There is no suggestion in the record that the equity owners desire to make a contribution on that basis, and that, *unless they are allowed to do it, under Ch. X, they will be barred.* * * *

Ch. X would not permit such a dilution of creditor's interests. Hence, such a showing does not establish on behalf of the stockholders that 'need for relief' which § 130 (7) read in the light of § 146 (4) requires. In fact, *the approval of the petition on that ground would be giving the equity owners a nuisance value* wholly unjustified by the reorganization standards which are incorporated into Ch. X." (Emphasis ours.)

The question was presented to the Third Circuit in *St. Charles Hotel Co.*, 149 F. (2) 645, and instead of writing a new opinion, the court stated that the opinion of the trial court (60 F. Supp. 322) was "an excellent opinion" which it *adopted* in lieu of its own, and certiorari was denied by the Supreme Court (66 S. Ct. 48). There the District Court originally approved the petition under Chapter X as filed in good faith and upon a motion to show cause why the order should not be vacated on the ground that it was unreasonable to expect that a Plan of Reorganization can be effected under the provisions of that Act, the Court vacated the order and dismissed the proceedings.

It pointed out (p. 325) that Section 146 of Chapter X defined the term of "good faith" by showing that in a prior proceedings the interest of creditors and stockholders could not be best served except in the reorganization proceeding and it referred to the "most recent complete expression" in *Marine Harbor Properties* v. *Manufacturers' Trust Co.*, 371 U. S. 78, where the property sought to be reorganized was worth less than the first mortgage debt and this Court there held "that the debtor petitioning under Chapter X had not sustained the burden which was upon it to show that the interests of the creditors and stockholders would best be served in the Chapter X proceeding where there was a prior State foreclosure proceeding pending." The District Court pointed out that when the answer contesting the good faith of the petition was filed it became "the burden of such petitioner to demonstrate that his petition is filed in good faith." In disposing of the contention there made that it was proper to file a petition which sought to reorganize the property for the benefit of only *one* class, the secured creditors, and in holding adversely to that decision the Court said (p. 328):

> "It was contended in the *Marine Properties* case, as it is contended by the Securities and Exchange Commission in this case, that there are numerous safeguards contained in Chapter X that are lacking in the state court proceedings. In that case the Schackno Act of New York, N. Y. Laws 1933, c. 745, Unconsol. Laws N. Y. § 4871 *et seq.*, was involved, whereas we are concerned with proceedings authorized under the New Jersey law in insolvency, receivership and reorganization. Title 14, Chapter 14, Revised Statutes of New Jersey of 1937, N. J. S. A. 14:14. We need not examine the differences between the two procedures, for the Supreme Court fully answers this contention as follows: 'Those considerations would be highly relevant and persuasive if this was a case of the usual reorganization proceeding dealing with

more than one class of securities under the older procedures which Ch. X was designed to improve and supplant * * *. Then the safeguards afforded by Ch. X would have special significance in protecting the respective classes of investors against improvident, unfair or inequitable adjustments, compromises, and settlements—steps which are basic to the reorganizaiton process but which in selfish hands led to much abuse."

The Court further said:

"In the language of the Supreme Court: 'In view of the burden on a petitioner to make the showing required by § 130 (7) and § 146 (4), the bankruptcy court is not warranted in assuming without more than a state foreclosure proceeding instituted for and on behalf of the first mortgage creditors exclusively is inadequate, measured by Ch. X standards, to protect their interests. The contrary course would result in Ch. X making greater inroads on prior proceedings than § 130 (7) and § 146 (4) indicate was the purpose.' *Marine Harbor Properties* v. *Manufacturer's Trust Co.*, 317 U. S. 78, at page 88, 63 S. Ct. 93, at page 98, 87 L. Ed. 64.

In fact, it appears from the record that if a plan of reorganization is effected it could consist of no more than an equivalent to a foreclosure of the rights of all creditors and stockholders other than the first mortgage bondholders. Whether the corporation be liquidated and the lienors paid off, whether foreclosure proceedings be taken and the property sold to the lienors, or whether the first mortgagees convert their bonds into stock as evidence of their ownership, the effect and net result would be the same—the first mortgage bondholders alone may participate in the proceedings and determine the ultimate form of their holdings."

It held that that petition was improperly approved as filed in good faith and vacated the previous order and

cited (p. 329) *Fidelity Insurance Association* v. *Sims*, 318 U. S. 608.

In Re Loewer's Gambrinus Brewery Co., 141 F. (2) 747, the Second Circuit said (p. 749):

> "Our decision in *Frank* v. *Drinc-O-Matic*, 136 F. 2d 906, is authority for the order of sale appealed from unless the opinion of Justice Roberts in *Fidelity Assurance Ass'n* v. *Sims*, 318 U. S. 608, 63 S. Ct. 807, 87 L. Ed. 498, stands in the way. But that opinion would not seem to have any bearing on the situation here. It merely states that a *petition for reorganization where liquidation*, and not a readjustment of the rights of creditors, *was at the very outset* the only possibility, *should be dismissed*, as not filed in good faith. The petition was attacked at the outset on the ground that it was not filed in good faith and the Supreme Court held that to institute a proceeding under Chapter X in case where there was no chance of reorganization was a violation of the statute. The Supreme Court said (318 U. S. at page 622, 63 S. Ct. at page 814):
>
> " 'Congress did not intend a Chapter X case to be turned into a liquidation proceeding at the outset, but intended the litigation to become a straight bankruptcy only after the failure to consummate a plan, and meant to limit the parties to their remedy in ordinary bankruptcy in all other cases.' "

This was restated in *Country Life Apartments* v. *Buckley*, 145 F. (2) 935, where the court said (p. 938):

> "Appellants also contend that the trustees' plan could not be confirmed in reorganization proceedings, because it was in reality not a plan of reorganization, but only a means of effecting the complete liquidation of the debtor's property, within the condemnation of *Fidelity Assurance Ass'n* v. *Sims*, 318 U. S. 608, 63 S. Ct. 807, 87 L. Ed. 1032. *That case, however, held merely that a petition is not filed in good faith where liquidation, and not a readjustment of the rights of credi-*

tors, was at the very outset the only outcome to be expected. There the petition was attacked for lack of good faith in the initial stages of the proceedings and the Court held that a proceeding could not be instituted under Chapter X where there was no chance of reorganization."

These views were repeated in *Patent Cereals* v. *Flynn,* 149 F. (2) 711, 713, where the Court said:

> "Finally, we cannot take the view of the District Judge that the opinion of Justice Roberts in *Fidelity Assurance Ass'n* v. *Sims,* 318 U. S. 608, 63 S. Ct. 807, 812, 87 L. Ed. 1032, required him to dismiss the reorganization proceeding under Chapter X and to proceed with the pending bankruptcy proceeding against the debtor. In *Fidelity Assurance Ass'n* v. *Sims, supra,* it was found that the petition for reorganization under Chapter X had not been filed in good faith because from the very outset it was apparent that no readjustment of the rights of creditors was possible and that 'the interests of creditors would be best subserved in the pending prior proceeding in West Virginia and other states.' See our opinions in *Re Loewer's Gambrinus Brewery Co.,* 2 Cir., 141 F. 2d 747, 749, and *Country Life Apartments* v. *Buckley,* 2 Cir., 145 F. 2d 935, 938, quoted as distinguishing *Fidelity Assurance Ass'n* v. *Sims* in *Matter of Lorraine Castle Apartments Bldg. Corp.,* 7 Cir., 149 F. 2d 55."

Even the Seventh Circuit adopted these views in *Lorraine Castle Apartment Bldg. Corp.,* 149 F. (2) 55, and there it held that where the petition was *contested at the outset,* and not after its approval, that the petition must be dismissed on appeal for want of good faith when it appears that the purposes are for liquidation and not reorganization. It also held on similar facts that such a petition was not filed in good faith (*Biltmore Grande Apartments,* 146 F. (2) 81, 83).

There was no contention that there was to be any new

contribution by a "stockholder" which is one of the essentials when the assets are valued at less than the secured debt (*Re Van Sweringen Corp.*, 155 F. (2) 1009, 1012) and here there were no stockholders in the real sense.

In *San Francisco Laundry Ass'n* v. *American Trust Company*, 127 F. (2) 187, the court construed the meaning of "good faith" and held that under Sections 144 and 146 (3), where it appeared that a debtor was insolvent, and that there is no reason to expect that a reorganization which is fair can be approved, the proceeding must be dismissed for want of good faith. There, the court said (p. 188):

> "The conclusion reached below was *that its value is substantially less than the obligation secured;* and the finding has ample support in the record. In the light of this finding and the admitted situation otherwise, *it is plain that the debtor is insolvent in the bankruptcy sense; and that there is no reason to expect that a reorganization can be effected. Hence the proceeding was not instituted in good faith* (§ 146 (3)) of the Act, 11 U.S.C.A., § 546 (3), and the dismissal was proper, (§ 144, 11 U.C.A.A. § 544). See *Chapman Bros. Co.* v. *Security First Nat. Bank of Los Angeles*, 9 Cir. 111 F. (2d) 86; *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1, 84 L. Ed. 110." (Emphasis ours.)

There is not a word in the opinion on the main issue on which the appeal was taken and it is clear that the approval of the petition as filed in good faith cannot be reconciled with the views of this court as interpreted by the various circuit courts of appeal.

The opinion relies a great deal (R. 108) on the fact that "other creditors came into court and joined the petitioners" and "the opposition was limited to a negligible number of claims" and those "supporting the petition are manyfold times as large as the opposing creditors". Sec-

tion 137 does not require a large group of creditors to challenge the good faith of a petitioner. The fact that other creditors came in to support does not count. The only creditors that came in to support are holders of $88,000 of the bonds as against the $21,000 owed by the petitioners here. The opportunity for creditors to speak will first come up when the matter will be submitted to vote. The court could not tell in advance that "two thirds" will support it as it evidently assumed (R. 109). On the issue of good faith the contest is only between the petitioner and the creditor who challenges the good faith and the coming in of other creditors in support of the petition cannot even be considered.

II.

The Debtor Was Conceived in Fraud and Its Petition Was Not Filed in Good Faith and It Was the Duty of the Court to Dismiss Its Petition for Lack of Good Faith.

The Protective Committee created the *Delaware* Corporation under its Plan of Reorganization. The members of the Protective Committee were to hold its stock for the benefit of the bondholders and their power was *limited* to *sell* the stock and *distribute* its proceeds or to *distribute the stock* pro rata (R. 62). In its letter of May 16, 1933 the Committee wrote to bondholders (R. 67) that now that the foreclosure was completed and the reorganized corporation acquired title to the property "the banker members of the Committee felt they should be replaced on the Board by bondholders or experienced real estate operators" and therefore "George W. Pearson, Ralph P. DeSwarte and Harry L. Schmitz resigned" and other persons, holders of "substantial" amount of bonds and a "well known real estate operator" replaced them.

It appears from the Petition (R. 6) that on September 29, 1938 an Illinois corporation was organized *under the*

same name and the property was conveyed to the Illinois corporation. One hundred shares were originally issued to three persons who *were not members of the committee* and later *all* of the 100 shares were issued to George W. Pearson for the benefit of the bondholders (R. 85). *This conveyance in 1938 from the Delaware corporation to the Illinois corporation was void.* The right of the Protective Committee to hold the stock was either to sell the stock or to distribute it pro rata among the bondholders. *They had no power to convey the property and to issue the new stock to Pearson.*

(a) The conveyance from the Delaware corporation to the Illinois corporation was to the prejudice of the beneficiaries and in breach of trust.

The creation of the Delaware corporation in 1932 was not an empty gesture. The evident reason for the organization of the Delaware corporation was to simplify a sale or mortgage of the property in the event of the distribution of the stock, as under the Delaware law a *majority vote* is sufficient for such purposes (Del. Code 1935, Sec. 65, p. 481). By the conveyance to the Illinois corporation they made it impossible to sell or mortgage without a two-thirds affirmative vote (Smith-Hurd Ill. Ann. Stat. Sec. 157.72). The Committee was only empowered (Tr. 28) to *hold* the stock "for the benefit of all holders of the First and Second Mortgage Bonds" and the "authority" was limited "to distribute the stock" of the company "pro rata" or "to sell the stock and apply the proceeds to the retirement of bonds" or "to distribute such proceeds pro rata among the bondholders." *The conveyance from the Delaware corporation to the Illinois corporation which completely wiped out the stock of the Delaware corporation was not within the powers conferred upon the Committee, and was wholly void.* The debtor, the Illinois corporation which was thus

conceived in fraud, is not such a corporation which can avail itself of the benefits of the Bankruptcy Act. It was not the intent of Congress to permit reorganization of "corporate cripples" which are "fit subjects for liquidation" (*Price* v. *Spokane Silver & Lead Co.,* 97 F. (2) 237).

(b) The issuance of all shares in the name of George W. Pearson was unwarranted and the debtor was not a bona fide corporation and its petition should have been dismissed.

Under the 1932 Plan of Reorganization *all* of the capital stock of the corporation was to be held by a committee composed of *five* members for the benefit of all bondholders (R. 28). The committee then consisted of five members of which George W. Pearson was its chairman (R. 61). Three of the members of this committee, the "banker members", including Pearson, *resigned* and they were *replaced* by others (R. 67). The original five members, and their successors *were to hold all of the stock for the benefit of the bondholders and to distribute it.* The committee of *five* became the trustees for the bondholders (*First National Bank* v. *Bryn Mawr Beach Bldg.,* 365 Ill. 409, 423). The *five* members of the committee were required to act *jointly* (*Hopkins* v. *Loeber,* 329 Ill. App. 423, 429). They had no right *to delegate their powers* or transfer such rights to *strangers* consisting of M. Barton, M. J. Fink, and B. P. Hayes to whom the Illinois corporation issued its stock to be held for the benefit of the bondholders (R. 85) nor did they have the authority to delegate their powers and duties to the only "banker member," George W. Pearson, who "resigned" and through some maneuver became the *only* stockholder, the president, and one of the directors. This is the most unusual corporate set up. *The entire corporation consists of one man.* He holds all the stock for all bondholders and *there is no authority shown anywhere*

how he became the trustee for them. The only authority under the Reorganization Plan was the issuance of the stock of the Delaware corporation to the *committee of five* and there was no authority to organize a new corporation, to issue new stock, and to have the stock issued in the name of one person, Pearson, and to entrust him with *all* the functions of the corporation.

In *Hammond* v. *Lyon Realty Co.*, 163 Md. 442, the court discussed the question whether a corporation which consists of only *one* stockholder may properly be considered *a functioning corporation* and in holding to the contrary, the court said (p. 450):

> "In *Swift* v. *Smith,* 65 Md. 428, 5 A. 534, it was intimated that ownership by one person of all the stock in a corporation virtually suspends its operations as a corporation until the election of new officers through new stockholders purchasing from that person. Whether in the light of more recent developments in the law the principle thus announced would be accepted now (*Dollar Dry Cleansers and Dyers, Inc.* v. *MacGregor,* 163 Md. 105, 161 A. 159), need not be decided, because the question here is not whether a one man corporation could as to all matters within the sphere of its legitimate corporate operations function as a corporation, but whether such a corporation can be used by its owner to to escape the application of legal rules and principles which would reach and control him as a natural person. And in reference to that question it was said in *Bauernschmidt* v. *Bauernschmidt,* 101 Md. 162, 60 A. 437, 442: 'In *Anthony* v. *American Glucose Co.*, 146 N. Y. 407, 41 N. E. 23, the court said, "We have of late refused to be always and utterly trammeled by the logic derived from corporate existence, when it only serves to distort or hide the truth"; and in *Seymour* v. *Spring* (144 N. Y. 333, 39 N. E. 365), *supra,* "The abstraction of the corporate entity should never be allowed to bar out and prevent the real and obvious truth." '

> This principle was recognized and applied in a different situation in *Pott* v. *Schmucker*, 84 Md. 535, 36 A. 592, in which it was held that 'it was competent for a court of equity to look back of the mere artificial and formal body corporate, * * * and to treat the corporation and the individual owning all its stock and assets as identical.' In Fletcher's Cyclopedia of Corporation, sec. 44, it is said: 'It is idle to promote a corporation for the purpose of endeavoring to accomplish fraud or other illegal acts under the cloak of the corporate fiction. Where this is attempted, courts of equity, or bankruptcy, do not hesitate to tear aside the veil of corporate entity and to look beyond it and through it at the actual and substantial beneficiaries. A notable instance is found in cases where it is sought to delay, hinder and defraud creditors by means of "dummy" incorporations. The courts have uniformly held that there is no magic in incorporation and refuse to apply the doctrine of corporate entity to enable such schemes to be successful.' "

This case applies with greater force here where the corporation was conceived in fraud and in violation of trust duties when the title was transferred from the Delaware corporation to the Illinois corporation, without distributing the stock of that corporation or the proceeds thereof, and the new stock of the Illinois corporation was issued in the name of *one* person, and this person acting as the only stockholder elected the directors, is the president of the corporation, and took it upon himself to refuse the offer of $1,200,000 cash a few months prior to the maturity of the bond issue and to later plunge the corporation into bankruptcy. Under the Illinois law the "three" incorporators were to be "stockholders" who subscribed and paid for the stock (Smith-Hurd Ill. Revised Statutes Annotated, Chap. 32, Sec. 157.46). Here the subscribers were "dummies" (R. 85) and immediately they

transferred all of the shares to *one* "dummy", Pearson (R. 85) and he exercised all of the rights of the real stockholders, the bondholders. While the Illinois corporation obtained its title in 1938, the liability on the bond issue was first assumed in August, 1946 (R. 86). The purpose is evident, to bring it within the provisions of the Act. *The petition of such a corporation cannot be said to be filed in good faith.*

The opinion holds that (R. 107), want of good faith is not "breach of fiduciary integrity". This view has no foundation in law. While a mere honest intent is not good faith there must be an honest intent in order to show good faith (*Snyder* v. *Fenner*, 101 F. (2) 736, 738 C. C. A. 3).

III.

The Proceedings Were Commenced to Prevent the Distribution of the Stock to the Bondholders Upon the Maturity of the Income Bonds Which Would Have Resulted in a Merger and Enabled the Holders of the Securities to Acquire the Property Without Any Proceedings and Without the Burdensome Expenses Attached Thereto and the Court Clearly Erred When It Held That the Petition Was Filed in Good Faith.

This was not a case where the interest of the secured creditors was distinct from the interest of general creditors or the owner of the equity. The bondholders and the stockholders were the same persons, and if the persons who plunged the corporation into bankruptcy had performed their trust duties a merger would have been effected and there would have been no need for reorganization.

(a) A merger is effected when the position of debtor and creditor is united in the same person.

The Illinois law is well settled that when the interest of the debtor and creditor is united in the same person, a merger at law is effected (*Donk* v. *Alexander*, 117 Ill. 330, 337; *Re McDermott*, 115 F. (2) 582). The common law rule of merger prevails in Illinois and such a merger may only be prevented in a court of equity for equitable reasons (*Biwer* v. *Martin*, 294 Ill. 489, 493-494).

(b) Equity will enforce or prevent a merger where the intention is clear and when the prevention is in the interest of justice.

While a merger at law is effected when the superior and junior interests become united in one person, a court of equity may prevent the merger when the prevention is in the interest of equity and justice (*Forthman* v. *Deters*, 206 Ill. 159). There it was said that while it is true that the question "whether or not a merger takes place in equity depends upon the intention of the parties and the variety of other circumstances" it is also true that "a merger will be prevented by equity only, however, for the purpose of promoting substantial justice."

(c) The prevention of the merger in the instant case is not in the interest of justice.

The opinion recognizes the rule (R. 109) that the question whether a merger will be prevented depends upon equitable reason. There are no equitable reasons to prevent the merger in the instant case so as to enable the debtor to file the petition and burden the estate with the large expenses of the trustee, his counsel, the fees of other attorneys and committees and all incidental expenses.

The identical question was decided in *First Trust Co.* v. *Crooked Creek R. & Coal Co.*, 243 Fed. 450, where the court in speaking of the merger of bonds into stock, which the bondholders held, said (p. 457):

> "The making of the mortgage or trust deed in suit, then, so far as it conveyed the property of the defendant company, was a conveyance of the legal title to secure the bonds so issued; but *just how the stockholders of the company could acquire any greater or other interest under the mortgage than they, as the legal holders of the stock of the company, already possessed, is not readily conceivable.* At most, the making of the mortgage by their own board of directors, if it had any effect as to the stockholders or creditors of the corporation at all, *would only operate as a merger of the mortgage or lesser estate in the greater or legal estate already held by the stockholders.* The merger of estates is said to occur when a greater estate and a lesser coincide and meet in one and the same person, without any intermediate estate existing in another. 2 Blackstone, Com. 177 (Cooley's Ed.); volume 5, Words and Phrases, First Series, and volume 3, Second Series; Bouvier's Law Dictionary (Rawle's 3d Ed.) title 'Merger,' and cases cited. There being no intermediate or other estate existing in any other person than the stockholders of the defendant company, the equitable estate or lien created by the mortgage, if it created any estate at all, merged or was absorbed by the greater or legal estate held by the stockholders." (Emphasis ours.)

This case is cited with approval by the Illinois Supreme Court in *St. Louis Trust Co.* v. *W. C. W. R. Co.*, 334 Ill. 147, 153. The only reason the court did not apply the theory of merger is because (p. 154) "Not all of the stockholders were bondholders and not all of the bondholders were stockholders" and "to constitute a merger the estates should unite in the same person in the same right." Here, *all* of the bondholders are stockholders and all of the

stockholders are bondholders and the two estates are united in the same person in the same rights, and there may be a *pro tanto* merger (*Hill* v. *Reno*, 112 Ill. 154).

The interest of the bondholders will be best served if the merger will not be prevented and each bondholder will become a stockholder in a corporation which will own the property free and clear from the mortgage debt. What benefit would the bondholders derive from keeping the mortgage alive? The foreclosure of the mortgage would only be against themselves. Their trustee would have to allege that there was a default in the mortgage, but this default is that of the person who is himself the holder of the mortgage. One may not "eat his cake and have it too" (*Commercial Merchants Nat. Bank & Trust Co.* v. *LeTourneau*, 137 F. (2) 87, 91). There could be no benefits derived from the prevention of the merger and the completion of the reorganization proceedings, and the only result would be a liquidation in bankruptcy instead of a liquidation either by voluntary consents under the terms of the old reorganiaztion plan, or by a sale under the terms of the trust deed, both of which, however, would become unnecessary if the merger will not be prevented. It is obvious that the best interests of the bondholders will be served if the stock will be distributed pro rata among the bondholders and the affairs of the corporation will be conducted in the ordinary course, as is usual and customary in corporate matters. The fact that only 100 shares have been issued and that the bondholders will receive fractional shares is of no importance as under the Illinois law fractional shares are entitled to vote, and, if necessary, the charter may be amended to increase the number of the shares.

Conclusion.

We have shown that the decision in the instant case which affirmed the approval of the petition as filed in good faith notwithstanding the contest at the outset of the proceedings and the proof that there was no hope of reorganization and that the best that could be accomplished was liquidation, is directly contrary to the decisions of this court as construed by other circuit courts of appeal, as well as by the same circuit that rendered this opinion. We have also shown that in the instant case no reorganization was necessary and the burdening of the estate with the appointment of a trustee, the attorney for the trustees, and the fees and expenses in connection therewith was completely unnecessary. The opinion in the instant case did not even discuss the points upon which the appeal was taken and a writ of certiorari should, therefore, be granted.

Respectfully submitted,

MEYER ABRAMS and
WILLIAM H. RUBIN,
Attorneys for Petitioners.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

No. 587

IN THE MATTER OF
DIVERSEY HOTEL CORPORATION,
AN ILLINOIS CORPORATION,
DEBTOR.

ABRAHAM KOSDON, SAM HAUSLINGER AND
BENJAMIN LAPINE,
Petitioners,

vs.

DIVERSEY HOTEL CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY.

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March 10, 1948.

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PETITIONERS' REPLY.

FACTS MISSTATED.

Respondent's statement (p. 3) that "all bondholders in the case, except the appellants, joined in the prayer of the petition" is not only a misstatement, but is based on a misconception of the Act. Bondholders may *not* join in a

voluntary petition by a debtor and their voluntary appearance in support of a petition cannot even be considered, as the act only authorizes a contest on the part of a creditor and their support is of no importance. Instead of "all" bondholders only $88,000 in bonds out of $1,387,500 came to the aid of the debtor.

The statement (p. 4) that the Illinois corporation was organized in 1938 for the purpose of superseding the Delaware corporation and that the former agreed to carry out the terms of the provisions of the trust deed and to pay the $1,387,500 in bonds should be considered in the light that the Illinois corporation was organized without the consent of the bondholders who were the beneficiaries of the stock and without their knowledge or approval, and that the Illinois corporation while organized in 1938, *did not assume the debt* of the bond issue until August 22, 1946 (R. 86) shortly prior to the maturity of the bond issue. It is not true as stated that the stock was issued to George W. Pearson as Chairman of the committee but was issued by the Illinois corporation *to three strangers:* Messrs. Barton, Fink and Hayes, (R. 85) who subsequently transferred their certificates, and new stock was issued in the name of Pearson, *individually,* after he had terminated his relationship as chairman of the committee (R. 67).

The statement of the respondent (p. 8) that the answer of the petitioners "admitted the insolvency of the debtor" is also inaccurate. The debtor alleged that it was *not* insolvent in the bankruptcy sense and insolvent in the sense that it was unable to pay the bonds at maturity (R. 6: ¶ 8) and the answer (R. 14: ¶ 8) denied that it was solvent and asserted that it was *insolvent in the bankruptcy sense.*

THE DECISION DIRECTLY CONFLICTS WITH THE VIEWS OF THIS COURT AS INTERPRETED BY OTHER CIRCUIT COURTS OF APPEALS.

The contention of the respondents that the decision in the instant case, which approved the petition as filed in good faith although contested at the *outset,* when it appeared that the value of its assets was less than the first mortgage indebtedness and that there are no other intervening creditors or stockholders, is not in conflict with the views of this court in the *Marine Harbor* case (317 U. S. 78) and *Fidelity Assurance Society,* (318 U. S. 608) is completely without merit. While the *Marine Harbor* case directly involved the construction of Section 146 (4) which is based on the pendency of a prior proceeding, it also laid down the rule of law with reference to Section 146 (3) which is not based on the pendency of a prior proceeding, and in the *Fidelity* case in the first part of its decision the court exclusively discussed Section 146 (3) which is not based on the pendency of any prior proceeding and squarely held that where the mortgage debt exceeds the value of the property and there are no rights to be adjusted among stockholders and creditors such a proceeding is not filed in good faith. After discussing this branch of the case this court said (p. 618):

> "It is urged that a plan of liquidation may constitute a reorganization under Chapter X, and decisions are cited to that point, but an examination of them will demonstrate that in none save where the corporate purpose of the debtor was, in effect, holding and liquidating securities was the plan such as is proposed here. Under the facts of this case, the suggested plan is but an alternative for ordinary bankruptcy, without any

readjustment of the rights of creditors and stockholders *inter se*, and this fact serves to distinguish the remaining cases on which reliance is placed.

"We conclude that, in this aspect, good faith, in the statutory sense, is lacking, since no such reorganization as the statute was intended to accomplish is reasonably to be expected."

In citing this case and in relying thereon in construing Section 146(3) *in re: Unity Life Ins. Co.*, 47 F. Supp. 355, 360, the court pointed out that the words "good faith" in the act do not connote "bona fide" but the term is a "technical one" and no matter how good the intentions of the parties may be, if it appears that a plan of reorganization cannot be expected and that liquidation is the ultimate result, the petition must be dismissed under Section 146(3) no matter how beneficial it may be. The decision was affirmed by the Fourth Circuit (136 F. (2) 133) which also cited the decision of this court on this point.

Even the Seventh Circuit so construed this part of the decision of this court in considering the first phase of the case in *Sheridan View Bldg. Corp.*, 149 F. (2) 532 and it concluded, independently of the point that there was a prior proceeding pending, that the proceeding was not initiated in good faith when it appeared from the outset that the mortgage indebtedness exceeded the value of the property.

While we are also of the opinion that the distinction between challenging at the outset of the proceedings and challenging at the conclusion of the proceedings is not a real distinction and that the various courts have misconstrued the meaning of the word "outset" in the opinion of this court, as it appears from the result of the decision *in re V. Loewer's Gambrinus Brewing Co.*, 141 F. (2) 747 where after sustaining the good faith because it was not challenged at the outset, the District Court was thereafter compelled to dismiss it when it appeared from the plan that

liquidation and not reorganization was the only possible result (58 F. Supp. 520), here, the good faith was challenged at the *outset* of the proceedings so that even that distinction is absent here.

In each of the cases that we cited in our Brief the various circuit courts distinguished the decisions of this court on the only point that in the two cases where this court decided that the petition was not filed in good faith the petition was assailed at the *outset*, while in the other cases it was assailed in connection with the reorganization plan. They are *unanimous* that where the petition is assailed at its outset and it develops that no rights of creditors or stockholders are to be adjusted and that the property is valued less than the first mortgage bond issue, that in such a case the petition is not filed in good faith under Section 146 (3).

Respondents are aware that in the decision of the Ninth Circuit in *San Francisco Laundry Association* v. *American Trust Company*, 142 F. (2) 187 there was no prior pending proceeding in the State Court and that the court squarely held that where the mortgage debt exceeds the value of the property that the petition must be dismissed under Section 146 (3). They seek to distinguish that case on the ground that there the court based its decision on the fact that the debtor was *insolvent in the bankruptcy sense* and here they say it is only insolvent in that it was unable to meet the bond issue at maturity. They overlooked the fact that when this issue was contested by the answer under Section 137 they were required under the two decisions of this court to meet this issue and to sustain their allegations by proof. Not only did they fail to meet this burden but the proof shows that *the corporation is insolvent in the bankruptcy sense* as shown in the Brief in support of the petition (pp. 17-18).

In view of the conflict of the decision in the instant case with the views of this court as construed by the other

circuit courts of appeals, it follows that the Writ of Certiorari should be granted. We will, therefore, not discuss the other points which were fully discussed in our Brief.

Respectfully submi‘ted,

MEYER ABRAMS,
WILLIAM HENNING RUBIN,
Attorneys for Petitioners.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947.

No. 587

ABRAHAM KOSDON, SAM HAUSLINGER AND BENJAMIN LAPINE,
Petitioners,

vs.

DIVERSEY HOTEL CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

REPLY TO BRIEF OF SECURITIES AND EXCHANGE COMMISSION.

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STATEMENT.

The reply to the brief of the Debtor may stand as a reply to the brief of the Securities and Exchange Commission, except for the additional matter which it introduced into this record by its statement (p. 6, marginal note 2) that on January 27, 1946 the District Court approved a plan which provides for the sale of the stock interest in the Debtor held by Pearson in trust for the bondholders out of which sale the bondholders will re-

ceive the payment of their bonds and the buyer will assume the reorganization expenses. This statement is inaccurate because the buyer will receive the $140,000 in cash which the Debtor has on hand out of which he will pay reorganization expenses, and the balance will belong to him. The whole thing is *contingent* upon the buyer being able to obtain a guarantee title issued by the Chicago Title and Trust Company guaranteeing the title free and clear from any objections. There should be added to the statement of the Commission that petitioners "have appealed from the order" that respondents moved to dismiss the appeal and the motion was denied.

Having brought this subject matter to the attention of the court, we feel it necessary to quote from our Memorandum of Law in opposition to the motion to dismiss the appeal, the following:

> "The Trustee was authorized under the plan of reorganization which the court approved to sell all of the stock of the corporation to the purchaser of the debtor's property. As a result of such purchase and of the placing of a new mortgage (contingent upon certain conditions) the bondholders will receive 100% on their bonds, plus 6% on the accumulated interest, which will be paid out of $120,000.00, which is in the possession of the trustee and belongs to the bondholders." *
>
> "The objections to the plan were on the ground that *the stock is not owned by the Debtor,* the corporation, but *is owned by the stockholders* and a bankruptcy court *is without jurisdiction to sell the stock which does not belong to the bankrupt.*"

The Memorandum further stated:

> "Section 111 of Chapter X confines the jurisdiction of the court to *'the debtor and its property'*. It does not vest jurisdiction in the Bankruptcy Court of property which *does not belong to the debtor.*

* The fund as of this date is $140,000.00.

Section 114 of the Act confines the jurisdiction of the court under that chapter to be 'the same as in a bankruptcy proceeding upon adjudication'. A bankruptcy court has no jurisdiction in ordinary bankruptcy of the stock which belongs to the individual stockholders and all it may adjudicate is a disposition of the property of the bankrupt.

Under Section 187 of the act, *the trustee is only possessed of the same powers of which a trustee in bankruptcy is possessed.* It is elementary that a trustee in bankruptcy of a corporation is only possessed of the property of the bankrupt corporation and *not of the stock which is owned by the stockholders.*

Article I, Section 216, Subsection 2, dealing with provisions of plan, confines it to *'the property of the debtor'.* No jurisdiction is conferred on the *property* of other persons. Subsection 7(b) provides for a sale of *'such property'* which is limited to the property of *the debtor* and excludes stock which is owned by *someone* else.

Neither under Section 77B nor under Chapter X was the Bankruptcy Court granted the power to deal with property which does not belong to the debtor. (*Re: Commonwealth Building Corporation,* 77 F. 2d, 308, 309; *Clarke* v. *Chase National Bank of the City of New York,* 137 F. 2d 797, 800; *Thompson* v. *Magnolia Petroleum Co.,* 309 U. S. 478).

It is only when a third party has property which is pledged to it *where the debtor has an interest* that a bankruptcy court has jurisdiction for the protection of the bankrupt's property to restrain the sale of the security in order to *preserve the equity of the debtor.* This is not the case here as the corporation has no interest in the stock which belongs *exclusively* to the stockholders.

Under no theory may a bankruptcy court order a sale of stock in a corporation and its jurisdiction is confined to a sale of the property and *not as to those who claim adversely to the corporation* (*Re: Standard Gas and Electric Co.,* 119 F. 2d 658, 661)."

The Memorandum also stated:

"Appellants did contest from the *outset* the 'good faith' of the petitioner in invoking the reorganization proceedings under the subterfuge that it was a reorganization, but actually a *liquidation proceedings.* The court in overruling our contention was evidently of the opinion that a reorganization would result from a plan which may hereafter be submitted. It now appears from the plan that the debtor *will be liquidated.* The approval of such a plan was not adjudicated on the prior appeal.

While tha plan proposes to pay the bonds 100% plus 6% in accumulated interest, the purchaser *will acquire the* $120,000.00 *in cash which is on hand,* so that he is actually paying the interest with the funds on hand, and he is also paying the expense of the reorganization with the funds on hand. *No new money is being added* and it is not the purpose to reorganize the property for the benefit of the bondholders who are also the stockholders. *The purpose is only to liquidate the property.* Such a plan was improperly approved, particularly when the objection was raised at the outset of the filing of the petition and *now the plan demonstrates that the proceedings were initiated for liquidation purposes.* This plan comes within the condemnation by the Supreme Court of the United States (*Marine Properties* v. *Trust Co.,* 317 U. S. 78, 83; *Fidelity Assurance Society* v. *Sims,* 318 U. S. 608, 615; *St. Charles Hotel Co.,* 604 F. Supp. 322, affirmed by 149 F. 2d 645; certiorari denied 66 S. Ct. 48)."

The Memorandum concluded:

"It is evident from the plan that it contemplates a sale not only of the property of the debtor, but also of the stock of the stockholders and *the sale is to be made to the proposed purchaser without competitive bidding.* There is no warrant in the law for the approval of a plan which contemplates a liquidation without competitive bidding.

Section 216(1) of Chapter X authorizes a sale at an 'upset price', but *does not authorize a sale without competitive bids.*

The only theory upon which this sale is predicated is under Section 216 (10). This section authorized an *upset price.* However, the upset price is *not the maximum* but the *minimum* and there *must be competitive bidding.* (Collier on Bankruptcy, Vol. 6, Page 3496 and authorities cited (14th Ed.)).

A sale of all of the stock, which includes the property at an appraised value without competitive bids, and without advertising, *constitutes the taking of the property without due process of law* which is also a prohibition against the bankruptcy court (*Louisville Joint Stock Land Bank* v. *Redford,* 295 U. S. 555)."

The foregoing quotations relating to the plan which was approved tend to support the challenge at the outset of the "good faith", and show that the proceedings were not initiated for reorganization, but for liquidation, and culminated in liquidation which a Bankruptcy Court is without power to execute.

For the reasons stated in the original petition, in the Reply to the Brief of the Debtor, and in this Reply, petitioners urge that the Writ of Certiorari be granted.

Respectfully submitted,

MEYER ABRAMS,
WILLIAM H. RUBIN,
Attorneys for Petitioners.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

No. 587

IN THE MATTER OF
DIVERSEY HOTEL CORPORATION,
AN ILLINOIS CORPORATION,
DEBTOR.

ABRAHAM KOSDON, SAM HAUSLINGER AND
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Petitioners,

vs.

DIVERSEY HOTEL CORPORATION,
Respondent.

MEMORANDUM IN OPPOSITION TO THE ISSUANCE OF A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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March 4, 1948.

THE BUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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IN THE

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Respondent.

MEMORANDUM IN OPPOSITION TO THE ISSUANCE OF A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

OPINIONS OF THE COURTS BELOW.

There was no opinion rendered by the Honorable Judge Campbell at the time of the entry of the Order appealed from on June 10, 1947. The opinion of the Circuit Court of Appeals is not yet reported and is printed in the Record at pages 104 to 109.

JURISDICTION.

The jurisdiction of this court is invoked under Judicial Code Section 240(a), 28 U.S.C.A. 547(a), as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED.

There is only one issue raised in this case, namely

"Was the petition filed in good faith pursuant to Section 130 (1 to 8) of Chapter X of the Bankruptcy Act?"

STATEMENT OF THE CASE.

On May 29, 1947, the DIVERSEY HOTEL CORPORATION, an Illinois corporation, filed a voluntary petition to reorganize under Chapter X of the Bankruptcy Act. There was no prior proceeding for reorganization pending in any court of any state or of the United States. All bondholders in the case, except the appellants, joined in the prayer of the petition. An order was entered by the Honorable Judge Campbell on June 10, 1947, finding the petition for reorganization to be filed in good faith and appointing a Trustee for the Debtor. This decision was affirmed unanimously by the Circuit Court of Appeals for the Seventh Circuit on January 21, 1948 (R. 104-109).

The Debtor owns a large office building and hotel located at Diversey and Broadway in Chicago. In 1932 there was issued and outstanding against this property first mortgage bonds amounting to $1,387,500.00 (R. 5). The bondholders at that time organized the Diversey Hotel Corporation, a Delaware corporation, for the purpose of acquiring and did acquire this property through foreclosure in the Superior Court of Cook County (R. 80).

A committee (George W. Pearson acted as Chairman) was organized and each bondholder was given a new first mortgage bond for his old bond (R. 80). The new bonds were 15 year income bonds maturing June 1, 1947. All of the stock of the new company was held by the committee for the benefit of the bondholders pursuant to the following authority (R. 81):

> "The Committee representing the bondholders will have authority to distribute the stock of the Company pro rata among the bondholders or to sell the stock

and apply the proceeds to the retirement of bonds, or to distribute such proceeds, pro rata, among the bondholders. Any stock held at the date of maturity of the bonds will be distributed pro rata amongst the then holders of such bonds."

Each bond bears the following legend (R. 62):

"In accordance with the plan of March 22, 1932, pursuant to which plan this bond was issued, at the time of issuance of this bond all of the capital stock of the Diversey Hotel Corporation was retained by a committee acting for the benefit of the holder of this bond and the holders of all other bonds secured by the Trust Indenture referred to in the within bond. At such time as the Committee holding such stock shall distribute the same the then registered owner of this bond shall be entitled to receive his pro rata share thereof."

In 1938, the Diversey Hotel Corporation, an Illinois corporation, was organized for the purpose of superseding the Delaware corporation of the same name. The Illinois corporation acquired all of the assets of the Delaware corporation, agreed to carry out the terms and provisions of the trust deed dated June 1, 1932, and assumed and agreed to pay the bonds of $1,387,500.00 (R. 86). There was issued 100 shares of stock to George W. Pearson who was the Chairman of the committee (R. 82). Interest from 1½% to 3% was paid on all bonds from 1938 to 1940 and thereafter 4% was paid to (but not including) June 1, 1947 (Supl. R. 1-7).

From time to time, the officers of the corporation attempted to sell the property. In August of 1946, they received a bid of $1,200,000.00 but were unable to accept it because the Chicago Real Estate Board appraised the property at $1,350,000.00 (R. 86). Under the terms of the trust deed dated June 1, 1932, no bid could be accepted

unless the bid was at least equal to the appraised value and this requirement was binding on the Continental Illinois National Bank & Trust Co., the indenture trustee, even though not less than 80% of the bondholders might approve a sale. The provisions pertaining to a sale of the properties are Sections 2, 3 and 4 on Pages 52-54 of the Trust Deed dated June 1, 1932, and read as follows:

"SECTION 2. Provided the Company shall not be in default hereunder to the knowledge of the Trustee,

(1) The Trustee shall release any part of the mortgaged property (but not the mortgaged property as a whole) from the lien of this Indenture, upon receipt by the Trustee of the following:

(a) A certificate signed by the President or a Vice President of the Company, describing the property which the Company desires to have released from the lien of this Indenture, stating that the Company has sold or entered into a contract for the sale of such property, the name and address of the purchaser, the terms and conditions of sale and the price for which the property has been sold or contracted to be sold.

(b) A copy of a resolution of the Board of Directors of the Company, certified by its Secretary under the corporate seal, authorizing the sale of such property upon the terms and conditions and for the price specified in the certificate referred to in the foregoing subparagraph (a) and requesting release of such property from the lien of this Indenture.

(c) A certificate of an appraiser satisfactory to the Trustee, certifying that he has appraised the property to be sold and that in his opinion such property does not have a fair market value in excess of the price specified in the certificate mentioned in the foregoing subparagraph (a) and that in his opin-

ion such price fairly represents the then value of such property.

(d) Cash or a certified check drawn upon a solvent banking institution to the order of the Trustee in an amount equal to the sale price of the property specified in the certificate referred to in the foregoing subparagraph (a), less such portion thereof, if any, as shall properly be payable to the trustee under the first mortgage.

(2) The Trustee shall release the mortgaged property as a whole from the lien of this Indenture upon receipt by the Trustee of the documents and cash or certified check required under subparagraph (a), (b), (c) and (d) of subdivision (1) of this Section 2, and, in addition thereto, written consents in form satisfactory to the Trustee, signed by the registered holders of not less than eighty per cent (80%) in principal amount of the bonds then outstanding consenting to the sale referred to in such documents and to the release of the mortgaged property from the lien of this Indenture.

SECTION 3. Upon any release by the Trustee of any part of the mortgaged property under the provisions of Section 2, Subdivision (1) of this Article, all cash paid to or deposited with the Trustee upon such release, after prior payment of all charges and expenses of the Trustee, shall become part of the sinking fund provided for in Article V hereof, and shall be applied to the retirement of bonds as provided in said Article V.

SECTION 4. Upon the release of the mortgaged property as a whole, as provided in Section 2, Subdivision (2) of this Article, all cash paid to or deposited with the Trustee upon such release shall, after prior payment of all charges and expenses of the Trustee, be distributed pro rata to the registered holders of the bonds, up to but not in excess of the principal amount

of the bonds outstanding plus interest thereon at the rate of six per cent per annum from June 1, 1932, to the last day of the calendar month preceding the month in which such distribution shall be made, less all interest theretofore paid on such bonds, upon surrender of their bonds to the Trustee for cancellation; and whenever the entire mortgaged property shall have been released from the lien of this Indenture as above provided, all of the outstanding bonds issued hereunder shall be deemed to have been fully paid, discharged and satisfied, and the rights of the holders thereof shall be limited solely to the right to receive a proportionate share of the moneys deposited with the Trustee, after prior payment of its charges and expenses as aforesaid, upon surrender of their respective bonds to the Trustee. Whenever such release shall have been effected, the Trustee shall mail a notice to each registered holder of bonds, addressed to him at his address as shown by the records of the Registrar, notifying such holder of the sale of the mortgaged property and release thereof from the lien of this Indenture, and advising such holder that upon presentation and surrender of his bond or bonds to the Trustee, he will be entitled to receive his pro rata share of the proceeds of such sale, after prior payment of all charges and expenses of the Trustee, as hereinabove in this Section provided. Any surplus of such proceeds remaining in the hands of the Trustee after all sums payable to the bondholders as aforesaid shall have been paid or set aside for payment shall be paid over to the Company."

Throughout the year of 1946 and winter and spring of 1947, the officers of the corporation continued their efforts to sell the properties (R. 90). Advertisements were placed in the leading daily newspapers of Chicago for this purpose (Exhibit C of Appellants' Answer, R. 23). But they were unable to make a sale. One of the appellants, Abraham Kosdon, appeared at a meeting of the board of di-

rectors held on April 22, 1947, for the purpose of inquiring about the purchase of the property. He talked about making a bid of $1,350,000.00, but this remained only in the talking stage. He said he did not have the earnest money (Supl. R. 15). Kosdon talked about making a deposit of $15,000.00 on a bid for the property and admitted that a $15,000.00 deposit on a bid of $1,350,000.00 would be an unfair deposit (Supl. R. 16). Kosdon discussed purchasing the building from the corporation for $1,350,000.00 (Supl. R. 15, 18), and was told that such a transaction would create an income tax payable by the corporation amounting to approximately $150,000.00 to $200,000.00 (Supl. R. 19). This, of course, would reduce the distribution to the bondholders by the same amount. Kosdon would not make a bid for the purchase of the stock of the corporation "simply because you would find yourself in another problem. I know there will be legal complications." (Supl. R. 24).

The officers and the corporation's attorneys considered and then abandoned as impracticable various plans to extend the maturity date of the bonds (R. 86-97).

The bonds of $1,387,500.00 became due June 1, 1947; the petition was filed May 29, 1947, and among other things alleged that the corporation was unable to pay its debts as they matured and prayed for the usual relief under Chapter X.

The answer of the appellants admitted the insolvency of the Debtor (R. 12) and that some sort of reorganization was necessary (R. 14).

ARGUMENT.

I.

THE DECISION OF THE CIRCUIT COURT OF APPEALS DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT OR OF ANY OTHER CIRCUIT COURT OF APPEALS.

Appellants allege in effect that the decision rendered by the District Court on June 10, 1947, and affirmed by the Circuit Court of Appeals on January 21, 1948, conflicts with two groups of cases: those construing Section 146 (3) of the Bankruptcy Act, 11 U. S. C. A. 546(3) and those interpreting Section 146(4) of the Bankruptcy Act, 11 U. S. C. A. 546(4).

(A) The Decision in This Case Does Not Conflict With Those Cases Interpreting Section 146(4) of the Bankruptcy Act Holding That Where There Is a Prior Proceeding Pending in a State Court the Petitioner Must Prove That the Interests of the Debtor Would Not Be Better Served in That Prior Proceeding.

Appellants rely mainly upon the decisions of this court in *Marine Harbor Properties, Inc.* v. *Manufacturers Trust Co.*, 317 U. S. 78, 87 L. Ed. 64 (1942), and *Fidelity Assurance Society* v. *Sims*, 318 U. S. 608, 87 L. Ed. 1032 (1943).

The decision in the *Marine Harbor Properties* case not only does not conflict with the decision in this case, but rather, in its dicta, emphasizes the soundness of this decision. The only issue in that case was whether the Circuit Court of Appeals had been in error in holding that a Debtor's petition was not filed in good faith where a prior proceeding for foreclosure had been pending in the state

courts of New York for over six months and where the Debtor had not offered any proof that the interest of the bondholders and stockholders would not be better subserved in that state court proceeding. The court said (p. 85):

> "When a prior proceeding is pending a petitioner's showing of 'need for relief' under Chapter X, required to be contained in every petition by the express provisions of 130(7), must demonstrate that at least in some substantial particular the prior proceeding withheld or denied creditors or stockholders benefits, advantages, or protection which Chapter X affords. In the absence of such a showing the need for relief has not been established."

In the case at bar no prior proceeding was pending as was properly alleged in the petition (R. 6). Thus this case is entirely inapposite as the only issue in the case at bar was whether the good faith provision of Section 144 of the Bankruptcy Act, 11 U. S. C. A. 544, had been met.

In *Fidelity Assurance Society* v. *Sims,* 318 U. S. 608, 87 L. Ed. 1032 (1943), there was a prior proceeding pending; this was also true of the case *In re St. Charles Hotel,* 149 F. (2d) 645 (C. C. A. 3d, 1945) where the Circuit Court of Appeals, in a *per curiam* opinion, merely asserted that the District Court had not been in error in denying a petition to reorganize under Chapter X where there were prior proceedings pending and the Debtor had not alleged that the interest of the bondholders would not be better subserved in that proceeding.

In *In re Biltmore Grand Apartment Building Trust,* 146 F. (2d) 81 (C. C. A. 7th, 1944), cited by appellants on Page 6 of their brief, there was a state court proceeding pending and the Circuit Court of Appeals merely affirmed the dismissal of the petition by the lower court, saying at p. 83:

> "A petition shall be deemed not to be filed in good

faith if a prior proceeding is pending in any court and it appears that the interest of creditors and stockholders would be best subserved in such prior proceedings."

(B) The Decision Does Not Conflict With Those Cases Interpreting Section 146(3) of the Bankruptcy Act and Which Hold That Where it Is Unreasonable to Expect That a Plan of Reorganization Can Be Effected the Petition Should Be Denied as Not Filed in Good Faith.

Section 146 of the Bankruptcy Act reads as follows:

"Without limiting the generalities of the meaning of the term 'good faith,' a petition shall be deemed not to be filed in good faith if—(3) it is unreasonable to expect that a plan of reorganization can be effected;"

In *Fidelity Assurance Society* v. *Sims*, 318 U. S. 608, 87 L. Ed. 1032 (1943), the debtor had been insolvent for many years and for immediately two years prior to the filing of the petition had been losing money heavily with little prospect of any change ever taking place. There also were suits pending in various state courts for appointment of receivers for its assets. The court held that in these circumstances it was reasonable for the Circuit Court of Appeals for the 4th Circuit to have found that there was no reasonable likelihood of an effective reorganization taking place; that all that reasonably could be expected was a liquidation.

In the case at bar the corporation was not insolvent in the bankruptcy sense, but was only unable to meet its debts as they matured (R. 5). The Record shows that for eight years the bondholders have been receiving 4% on their investment and that for ten years have been receiving interest (Supl. R. 1-7) and that annual gross rentals are over

$216,000.00, according to appellants' own Exhibit C (R. 23), which is over fifteen per cent of the total indebtedness and that the Chicago Real Estate Board appraised the property at $1,350,000.00, which in itself is only $37,500.00 less than the total bonded indebtedness of $1,387,500.00.

Thus we see that the situation of the Debtor is in no sense hopeless and that reorganization can effectively take place. As stated by the Honorable Judge Evans in the opinion below (R. 106),

"Their hopes are brighter today than ever."

In *San Francisco Laundry Ass'n* v. *American Trust Co.*, 127 F. (2d) 187 (C. C. A. 9th, 1942), cited by appellants on page 26 of their brief, there was a specific finding by a Special Master after hearing evidence and by the District Court that the Debtor was insolvent in the bankruptcy sense and that there was no reason to believe that a reorganization could take place. The court said at p. 188:

> "The finding has ample support in the record. In the light of the finding and the admitted situation otherwise, it is plain that the debtor is insolvent in the bankruptcy sense; and that there is no reason to expect that a reorganization can be effected. Hence the proceeding was not instituted in good faith, Sec. 146 (3) of the Act, 11 U. S. C. A. 546 (3), and the dismissal was proper, Sec. 144, 11 U. S. C. A. Sec. 544."

Thus this case clearly follows within the rule of *Fidelity Assurance Society* v. *Sims*, 318 U. S. 608, 87 L. Ed. 1032 (1943), and in no way conflicts with the decision in our case.

The cases of *In re V. Loewer's Gambrinus Brewing Co., Inc.*, 141 F. (2d) 747 (C. C. A. 2d, 1944), cited by appellants on pages 6 and 24; *Country Life Apartments, Inc.* v. *Buckley*, 145 F. (2d) 935 (C. C. A. 2d, 1944), cited in appellants' brief on pp. 6 and 24; and *In re Lorraine Castle Apartments Bldg. Corp.*, 149 F. (2d) 55 (C. C. A. 7th, 1945),

cited by appellants on pages 6 and 25, all involve appeals from orders approving Plans of Reorganization. None of them involve an appeal from the granting of a petition. Rather than support appellants' view, they support the view of the Appellee as the Plan which was approved by the lower court, whose decision was affirmed in *In re Lorraine Castle Apartments Bldg. Corp.*, 149 F. (2d) 55 (C. C. A. 7th, 1945), involved the sale of all the assets of the debtor by which payments of one hundred cents on the dollar, plus interest, were made to all bondholders, which is very similar to the situation at bar as here the appellants are contending that the likelihood of such a Plan prevents the petition from being filed in good faith.

In both *In re Loewer's Gambrinus Brewing Co., Inc.*, 141 F. (2d) 747 (C. C. A. 2d, 1944), and *Country Life Apartments, Inc.* v. *Buckley*, 145 F. (2d) 935 (C. C. A. 2d, 1945), the court affirmed orders of the District Court for the sale of all the assets of the Debtor. In the latter case the court said at p. 938:

> "Here when the petition was filed it did not appear that the debtor had no chance for reorganization or that reorganization would not be a reasonable method of serving the best interests of creditors and stockholders."

In *In re Loewer's Gambrinus Brewing Co., Inc.*, 141 F. (2d) 747 (C. C. A. 2d, 1944), Judge A. N. Hand speaking for the court, said (p. 749):

> "In the case at bar it was not apparent when the petition was filed that the debtor had no chance of adjusting the claims of its creditors and of ultimately resuming the operation of its rehabilitated brewery."

Thus, we submit that no case cited by the appellants in any wise conflicts with the decision of the Circuit Court of Appeals in the case at bar, and thus there are no grounds

for the issuance of a writ of certiorari because of any conflict with decisions of this court or of any other Circuit Court of Appeals.

II.

A WRIT OF CERTIORARI WILL NOT BE GRANTED TO REVIEW THE VERBIAGE OF A CIRCUIT COURT OF APPEALS OR TO REWRITE THE OPINION BUT ONLY TO REVIEW INCORRECT DECISIONS.

Reasons 2, 3 and 4 cited by the appellants for the issuance of the writ (Appellants' Petition, pp. 7-8), all deal with the dicta of the opinion in the Circuit Court of Appeals. They in no wise affect the decision of the court which was that the District Court was correct in finding that the petition met the statutory requirements of Sec. 130 of the Bankruptcy Act, 28 U. S. C. A. 530. Certiorari is granted to review incorrect decisions on legal questions, not to rewrite the opinion of the Circut Court of Appeals. Thus, we need not discuss them any further.

III.

UNSUPPORTED ALLEGATIONS OF FRAUD ARE NOT GROUNDS FOR THE ISSUANCE OF A WRIT OF CERTIORARI.

Pages 27 to 32 of appellants' brief in support of their petition, deal with allegations of fraud. The Record is barren of a scintilla of evidence of fraud. Mere allegations of fraud do not give jurisdiction. The words themselves, unsupported by facts, are mere vituperations. In *First National Bank* v. *Bryn Mawr Bldg. Corp.*, 365 Ill. 409 (1937), the court said at p. 430:

> "Counsel for appellants throughout their brief use strong language in charging fraud. Fraud is a charge easy to make, particularly under the protection of court proceedings."

And in *Ashton* v. *MacQueen*, 361 Ill. 132 (1935), the court said at p. 143:

> "No citation of authority is necessary to support the statement that fraud is not presumed, and statements by way of general conclusions of fraud are not sufficient in a pleading."

And in *Doose* v. *Doose*, 300 Ill. 134 (1921):

> "An allegation of conspiracy, collusion and fraud must show the facts upon which it is based. The words themselves, unsupported by facts are mere vituperations."

Also see *Felt* v. *U. S. Mortgage and Trust Co.*, 231 Ill. App. 110 (1923); *Haskell* v. *Art Institute of Chicago*, 304 Ill. App. 393 (1940); *Dickinson* v. *Dickinson*, 305 Ill. 521 (1922).

Fraud is also a question of fact and an error in the decision of a question of fact is not adequate grounds for the issuance of a writ of certiorari.

IV.

A WRIT OF CERTIORARI SHOULD NOT BE ISSUED TO REVIEW THE QUESTION OF MERGER.

(A) Merger Is a Question of Fact.

Whether a merger has taken place or not is not a question of law but a question of fact depending upon all the facts, including all the surrounding circumstances of the individual case and the decision will not be altered by a reviewing court if any evidence supports the decision of the lower court.

(B) There Was No Merger.

Mergers are not favored in the law. *Clark* v. *Glos,* 180 Ill. 556 (1899): "Mergers are not favored either in courts of law or in equity." *Wechter* v. *Chicago Title and Trust Co.,* 385 Ill. 111 (1944).

Merger is a question of fact depending upon the intent of the party or parties owning the equity of property and mortgage at the same time. *Factors and Traders Insurance Co.* v. *Murphy,* 111 U. S. 138, 38 L. Ed. 582 (1884), where this court said (p. 144):

> "The question is always upon the intention, actual or presumed, of the person in whom the interests are united."

This is the law in Illinois. *Richardson* v. *Hockenhull,* 85 Ill. 124 (1877); *Security Title and Trust Co.* v. *Schlender,* 190 Ill. 609 (1901); *Moffet* v. *Farwell,* 222 Ill. 543 (1906); *Edgar County Bldg. and Loan Assn.* v. *Cablin,* 268 Ill. App. 125 (1932); *Hooper* v. *Goldstein,* 336 Ill. 125 (1929), where the court said at p. 133:

> "But a merger is not a necessary result of the union of the two estates of the same person. The intention and interest of the party who unites the two estates in himself will determine whether or not a merger takes place."

In its latest pronouncement on the subject, the Illinois court said, *Chicago Title and Trust Co.* v. *Wolchinovesky,* 326 Ill. App. 194, 200 (1945):

> "On the question of merger, it is well settled in this state that merger is a question of intention, and that no merger of a lesser estate will result unless there is shown that the party who owns the two estates actually intended that a merger should result."

This is the law in general. *Shreve* v. *Harvey,* 74 N. J. Eq. 336 (1908); *Commercial Merchants National Bank and*

Trust Co. of Peoria v. *LeTourneau*, 137 F. (2d) 87 (C. C. A. 7th, 1943), *cert. denied* 320 U. S. 778, 64 S. Ct. 93, 88 L. Ed. 469 (1943); 2 Jones on Mortgages, Sec. 1080, Page 509; 2 Pomeroy's Equity Jurisprudence (4th Ed.), Sec. 791; Wiltsie on Mortgage Foreclosure (4th Ed.), Sec. 264, Page 364.

It is therefore clear that no merger of the stock and lien securing the bonds took place by operation of law and certainly there has been no expressed intent on the part of the bondholders to effectuate merger. If there is any intent on the part of the bondholders, it is to the contrary and against the theory of merger. The bondholders created a corporation and had their stock held in the name of a trustee, to be voted in their behalf for approximately 15 years. There is nothing to indicate that they intended to have the corporation considered non-existent at any time. On the contrary, all bondholders who intervened in this case, with the sole exception of appellants, filed answers praying that an order be entered finding the petition to be filed in good faith. This alone indicates an intention against merger—an intention to continue the legal entity of the corporation. Even appellants did not, prior to their oral argument before the Circuit Court of Appeals, at any times allege that there was a merger, but have contended that the bondholders should be relegated to their rights to foreclose in the state courts, thereby also indicating an intention against merger.

There is also a further obstacle to merger in the case at bar. In order to effectuate a merger here it is necessary to disregard the corporate entity. Courts of equity will only disregard the corporate entity in exceptional cases—only where it is being used to perpetrate a palpable injustice. *In re Commonwealth Light and Power Co.*, 86 F. (2d) 474 (C. C. A. 7th, 1936); *In re John Koke Co.*, 38 F.

(2d) 232 (C. C. A. 9th, 1930); *Kingston Dry Dock Co.* v. *Lake Champlain Transp. Co.*, 31 F. (2d) 265 (C. C. A. 2d, 1929); *Owl Fumigating Corporation* v. *California Cyanide Co.*, 24 F. (2d) 718 (D. Del., 1928); *Boatmans' Bank* v. *Gillespie*, 209 Mo. 127 (1908); *Berkey* v. *Third Avenue Railway Co.*, 244 N. Y. 84 (1926), (Opinion by Mr. Justice Cardozo).

In *In re John Koke Co.*, 38 F. (2d) 232, 233 (1930), the court said:

> "The rule is quite elementary that a corporation is an entity separate and distinct from its stockholders, with separate rights and liabilities; and this is true even though a single individual may own all, or nearly all, of the capital stock."

Illinois decisions so holding, include *McDermott* v. *A. B. C. Burner Sales Corp.*, 266 Ill. App. 115 (1932); *Illinois Interior Finish Co.* v. *Poenie*, 277 Ill. App. 554 (1934), and *Wollenberger* v. *Hoover*, 346 Ill. 511 (1931), where the court said at p. 575:

> "A stockholder, though he owns 99% of the corporation, is not the corporation and is not the owner of the property of the corporation."

Thus we see that in order for this court to adopt the merger theory, it would be compelled to ignore the legal entity of the corporation which it would do only to redress fraud or otherwise prevent a grave injustice. There has been no showing of fraud in this case and if anyone needs protection it is the bondholders, which can be best accomplished by permitting them to reorganize the Debtor under Chapter X.

Conclusion.

We have shown that the decision of the District Court which was unanimously affirmed by the Circuit Court of Appeals does not conflict with any decision of this court or of any other Circuit Court of Appeals; that there was no evidence of any fraud; that there was no merger of the stock and bonds; and that the other grounds alleged for issuance of a writ of certiorari are without substance. Therefore, the Diversey Hotel Corporation, an Illinois Corporation, Debtor Appellee, prays that the petition for a writ of certiorari to review the decision of the Circuit Court of Appeals for the Seventh Circuit, be denied.

Respectfully submitted,

EDWARD BLACKMAN,
Attorney for Appellee.

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779411—48

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 587

ABRAHAM KOSDON, SAM HAUSLINGER AND BENJAMIN LAPINE, PETITIONERS

v.

DIVERSEY HOTEL CORPORATION

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINION BELOW

The opinion of the circuit court of appeals (R. 104–109) has not yet been reported. The district court did not file an opinion in this matter.

JURISDICTION

The judgment of the circuit court of appeals was entered on January 21, 1948 (R. 110). The petition for writ of certiorari was filed on February 12, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether both courts below erred in finding that the debtor's petition for reorganization was filed in good faith.

STATUTE INVOLVED

Section 146 of the Bankruptcy Act, as added by the Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 887 (11 U. S. C. 546):

> Without limiting the generality of the meaning of the term "good faith", a petition shall be ~~deemed~~ not to be filed in good faith if—
>
> (1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or
>
> (2) adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act; or
>
> (3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

STATEMENT

On May 29, 1947, the debtor, an Illinois corporation, filed in the District Court for the Northern District of Illinois a petition for reorganization under Chapter X of the Bankruptcy Act (R. 2–8). Shortly after the petition was filed, certain holders of bonds of the debtor totaling

$88,000 filed answers thereto, joining in the prayer for relief under Chapter X contained in the debtor's petition (R. 9–11). The petitioners herein, who hold bonds of the debtor totaling $21,000, filed answers praying that the petition for reorganization be dismissed for lack of good faith (R. 12–20, 25–26). The district court entered an order on June 13, 1947, approving the petition as filed in good faith and in compliance with the requirements of Chapter X (R. 34). On appeal, the order of the district court was affirmed (R. 110). The Securities and Exchange Commission became a party to the proceedings in the district court pursuant to Section 208 of Chapter X, and participated as an appellee in the appeal (R. 57).

The petition for reorganization alleged that the total value of all of the debtor's property, real and personal, is $1,512,902.72 (R. 4–5). The debtor has substantial earning power as a going concern, as evidenced by its gross rents as of May 1, 1947, amounting to over $216,000 (R. 23).[1] The debtor's liabilities, exclusive of its capital stock, total $1,424,578.74 (R. 5). The principal liability is upon the outstanding First and General Mortgage Income bonds in the amount of $1,387,500 which matured on June 1, 1947 (R. 5).

[1] The supplemental (unprinted) record in the court below (pp. 3–5), not brought to this Court, shows that the debtor realized net earnings from operations sufficient to pay interest at 4% on its outstanding bonds since 1941.

The inability of the debtor to pay these bonds upon their maturity precipitated the institution of the proceedings for reorganization. Petitioners contend (Pet. 17–18) that the value of the debtor's assets is slightly less than the amount of its debts.

In 1932 the real estate of the debtor was the subject matter of a foreclosure suit. The principal amount of the bonds outstanding at that time was the same as it is now, namely, $1,387,500. The bondholders, through a committee, caused the property to be bid in at the foreclosure sale by a newly created Delaware corporation, Diversey Hotel Corporation. This corporation then issued to bondholders its new bonds, par for par with the old bonds, and secured by a new first mortgage dated June 1, 1932, upon the real estate. The corporation also issued all of its capital stock, 100 shares of $10.00 par value, to the committee, of which George W. Pearson was chairman, in trust for the benefit of bondholders. The members of this committee, who became the directors of the Delaware corporation, were authorized by the trust deed securing the new bonds to distribute the stock pro rata among the bondholders or to sell the stock and distribute the proceeds among the bondholders, and it was further provided that any of the stock held at the maturity of the bonds must be distributed among the bondholders (R. 5–6, 28–29).

On September 29, 1938, the Delaware corpora-

tion caused its real estate and other property to be conveyed to Diversey Hotel Corporation, an Illinois corporation, the debtor herein (R. 6). All of the stock of the debtor, 100 shares of $10.00 par value common, was issued to George W. Pearson for the benefit of the bondholders (R. 85). The debtor subsequently assumed and agreed to pay the outstanding bonds (R. 6, 86).

Within a year prior to the maturity of the bonds, the officers and directors of the debtor endeavored to sell the property. The debtor had its property appraised, advertised it for sale, and solicited bids for its purchase. An obstacle to sale appeared to be uncertainty as to whether a marketable title could be conveyed by George W. Pearson, Trustee (R. 92). The only firm bid received was $1,200,000, less than the appraised value of the properties and less than the full amount of the debts (R. 86, 106). No sale was effected.

ARGUMENT

There is no substance to petitioners' contention that the decision of the court below is in conflict with the decisions cited by petitioners. The debtor being unable to meet its maturing obligations, and being unable under its existing security structure to effectuate a sale of its assets without difficulties which might impair realization of an adequate value, it was clearly necessary to effectuate a reorganization, either under Chapter X or otherwise, in order to salvage the substantial going concern value of its business. No prior pro-

ceeding for reorganization was pending in any court and, unlike the situation in many of the cases relied upon by petitioners, there was no problem under Section 146 (4). The courts below were clearly warranted in concluding under Section 146 (3) that it was not "unreasonable to expect that a plan of reorganization can be effected" either through effecting a modification of the debtor's security structure or through a sale plan in the event that a sufficiently attractive offer to purchase the properties should be forthcoming.[2] Petitioners advance no argument as to why the proceeding under Chapter X would not redound to their advantage as well as to that of all other security holders, but merely advance a series of technical objections based, we believe, upon a misreading of the authorities cited. No question is raised which requires consideration by this Court.

1. *Marine Harbor Properties* v. *Manufacturers Trust Company,* 317 U. S. 78; *In re St. Charles Hotel Company,* 149 F. 2d 645 (C. C. A. 3), certiorari denied, 326 U. S. 738; and *In re Biltmore Grande Apartment Building Trust,* 146 F. 2d 81

[2] Subsequent to the decision below the reorganization court, by order dated January 27, 1946, approved a plan providing for the sale of the stock interest in the debtor held by Pearson in trust for the bondholders, payment in full of the debtor's outstanding bonds with interest for the year 1947, and assumption by the reorganized corporation of all other obligations of the debtor. Petitioners have appealed from that order.

(C. C. A. 7), upon which petitioners rely, each involved a prior proceeding pending in a state court, and held that under the facts of the particular case the burden of showing that the interests of creditors and stockholders would not be best subserved in the prior proceeding had not been sustained and that, consequently, the petition for reorganization would not be approved as filed in good faith under Section 146 (4) of Chapter X.

Likewise, there is no conflict with *Fidelity Assurance Association* v. *Sims,* 318 U. S. 608, in which this Court held that where it appears at the inception of a proceeding that the only course open to the corporation is a piecemeal liquidation of its assets and a distribution of the cash proceeds among its creditors, a Chapter X proceeding is inappropriate. Obviously, liquidation of the debtor's estate in the instant case is not required or inevitable. The debtor's property has substantial income and the preservation of going concern value, as an alternative to a forced sale of assets, is available to the bondholders if they choose to have a plan of reorganization so providing.

However, various types of plans are permissible under Chapter X including a sale type of plan as held by *In re V. Loewer's Gambrinus Brewery Company, Inc.,* 141 F. 2d 747 (C. C. A. 2); *Country Life Apartments* v. *Buckley,* 145 F. 2d 935 (C. C. A. 2); and *In re Lorraine Castle Apartments Building Corporation,* 149 F. 2d 55 (C. C. A. 7), certiorari denied, 326 U. S. 728,

While these cases are also cited by petitioners, their applicability is not apparent. If the bondholders prefer a plan of reorganization calling for a sale of the debtor's properties, these cases simply hold that they may accomplish such a liquidation under the provisions of chapter X. However, there is no requirement that the property be liquidated, and if for any reason the bondholders deem it to be in their best interest not to liquidate, they have the alternative of insisting upon a plan under Chapter X providing for an exchange of their old securities for new securities in a reorganized company.

The petition of the debtor for reorganization alleges certain facts which indicate solvency. The controverting answer asserts that the debtor is insolvent. Whether the debtor is insolvent or merely unable to meet its debts as they mature, there can be no serious question as to the existence of a pressing need for relief. Under Section 130 (1), Chapter X is available to a debtor which is insolvent in either sense. See also Sections 179 and 216 (8), which expressly contemplate plans of reorganization which may exclude stockholders.

2. Petitioners' remaining contentions are based upon the somewhat unusual problems growing out of the early abortive reorganization of the debtor, and the circum[illegible] that its principal liabilities are to bondhold[illegible]ho are also the beneficial owners of its common stock. In that

connection petitioners raise points of state law which were rejected by the court below as without merit and which do not in any event present questions of recurrent importance in the administration of Chapter X. It is urged (Pet. 27–29) that the petition for reorganization was not filed in good faith because the debtor was "conceived in fraud". But there was no allegation of fraud in petitioners' answer or amended answer to the Chapter X petition, and there is no evidence of fraud in the record. The assumed fraud is the conveyance of the property by the Delaware corporation to the Illinois corporation and the issuance of all of the shares of the latter corporation in the name of George W. Pearson (Pet. 28–32).

Petitioners argue (Pet. 28) that the Illinois corporation law is more stringent than the Delaware law as it requires the affirmative vote of the holders of two-thirds of the stock in order to sell or mortgage the property of a corporation, whereas the Delaware law requires only a majority vote. This difference in legal requirement would be significant, if at all, only after the stock had been distributed as, obviously, Pearson as trustee for the bondholders has continuously held 100% of the stock.

The further argument is made that the transfer of all of the stock to George W. Pearson as trustee was beyond the power of the original trustees of the stock (Pet. 29–30). This is a fruitless argument. Pearson is an acknowledged

trustee of all of the debtor's stock for the benefit of the bondholders. There is no evidence that the bondholders have been injured by having as trustee one individual rather than another, or some others. If so, Chapter X provides a proper forum for effecting a remedy if such injury has also been suffered by the estate of the debtor.

3. Petitioners assert (Pet. 32) that if the stock of the debtor corporation were to be distributed ratably to the bondholders, the bonded indebtedness would be extinguished by reason of a merger inasmuch as the same persons would be both bondholders and stockholders. This point was not raised in the district court, nor in the original or reply briefs of petitioners in the circuit court of appeals. It was first raised by one of the judges of the circuit court of appeals upon the occasion of the oral argument before that court. Having raised it, the circuit court of appeals disposed of it in its opinion (R. 108–109).

As the circuit court of appeals points out, "merger is at best determined by intention" (R. 109). There is no evidence in the record as to the intention of the parties with respect to merger except what is contained in the 1932 trust deed and what may be inferred as to their intention with respect to keeping the encumbrance alive in the best interest of the bondholders. The practical consequences of a holding that upon the distribution of all of the stock in a new corporation to its bondholders the bonds would im-

mediately cease to represent a debt and therefore have no value, and that all of the value would reside in the stock because of the extinguishment of the debt, would obviously be most unfortunate, if not disastrous, to the individual bondholders.

CONCLUSION

The decision of the court below is correct, and there is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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MARCH 1948.

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